

IN THE
United States Court of Appeals
FOR THE THIRD CIRCUIT.

No. 14516.

UNITED STATES OF AMERICA and
ERNEST J. TIBERINO, JR., Special Agent,
Internal Revenue Service,

v.

MAX POWELL and WILLIAM PENN LAUNDRY, INC.,
Appellants.

On Appeal From Judgment of the United States District
Court for the Eastern District of Pennsylvania.

APPELLANTS' APPENDIX.

BERNARD G. SEGAL,
FRED L. ROSENBLOOM,
SAMUEL D. SLADE,
Attorneys for Appellants.

SCHNADER, HARRISON, SEGAL
& LEWIS,

1719 Packard Building,
Philadelphia 2, Pennsylvania,
Of Counsel.

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'APPELLANTS' APPENDIX.

RELEVANT DOCKET ENTRIES.

1. May 20, 1963. Petition to enforce Internal Revenue Service Summons, filed.
2. May 27, 1963. Order of Court fixing June 5, 1963 at 10 a.m. for hearing to show cause, filed. 5-28-63 noted.
3. June 5, 1963. Certified copy of order to show cause returned "on 5-29-63 served" and filed.
June 5, 1963. Hearing sur order to show cause—order to be entered.
4. June 5, 1963. Order of Court that defendants produce certain documents for inspection, etc., filed. 6-6-63 noted & notice mailed.
5. Answer to petition and order to show cause filed.
6. June 7, 1963. Notice of appeal by respondents, filed. Copy to U. S. Atty. on 6-7-63.
7. June 7, 1963. Copy of Clerk's notice to U. S. Court of Appeals, filed.
June 7, 1963. Respondents' bond for costs on appeal in \$250. with The Travelers Indemnity Co. as surety, filed.
8. June 8, 1963. Stipulation of counsel and Order of Court postponing Order of this Court entered June 5, 1963, pending appeal, filed. 6-10-63 noted & notice mailed.
5. June 5, 1963. Answer to petition and order to show cause, filed.
9. June 12, 1963. Transcript of hearing of 6-5-63, filed.

ORDER TO SHOW CAUSE.

Upon the petition, the exhibits attached thereto, the affidavit of Ernest J. Tiberino, Jr., Special Agent, Internal Revenue Service, and upon the motion of Drew J. T. O'Keefe, United States Attorney.

BE IT ORDERED, that Max Powell, President of William Penn Laundry, Inc., appear before the District Court of the United States for the Eastern District of Pennsylvania, in that branch thereof presided over by the undersigned, in his Court Room in the U. S. Courthouse on June 5, 1963, at 10 A. M. to show cause why he should not be compelled to produce the papers, books and records demanded in the Internal Revenue Summons served upon him on March 13, 1963, by the petitioner.

LET A COPY OF THIS ORDER, together with the petition and the exhibits attached thereto, be served personally upon the said MAX POWELL at least five days prior to the time set herein for hearing.

Dated at Philadelphia, Pennsylvania, this 27th day of May, 1963.

By THE COURT:

/s/ ALLAN K. GRIM,
United States District Court Judge.

**PETITION TO ENFORCE INTERNAL REVENUE
SERVICE SUMMONS.**

Come now the United States of America and Ernest J. Tiberino, Jr., by their attorney, Drew J. T. O'Keefe, United States Attorney for the Eastern District of Pennsylvania, and show unto this Court as follows:

I.

This is a proceeding brought under the authority of Section 7604(b) of the Internal Revenue Code of 1954 to judicially enforce an Internal Revenue Summons.

II.

The petitioner, Ernest J. Tiberino, Jr., is a Special Agent of the Internal Revenue Service employed in the Intelligence Division of the office of the District Director located at Philadelphia, Pennsylvania.

III.

The respondent, William Penn Laundry, Inc., is a corporation incorporated pursuant to the laws of the Commonwealth of Pennsylvania and maintains its principal place of business within the city of Philadelphia, Pennsylvania.

IV.

The respondent, Max Powell, resides at 6138 Old York Road, Philadelphia, Pennsylvania.

V.

The petitioner, Ernest J. Tiberino, Jr., is conducting an examination of the books and records of the respondent, William Penn Laundry, Inc., for the purpose of ascertaining the correctness of corporate income tax returns filed by

the respondent; William Penn Laundry, Inc., for its fiscal years ending July 31, 1958, and July 31, 1959.

VI.

On February 26, 1963, Dean J. Barron, Regional Commissioner, Internal Revenue Service, a delegate of the Secretary of the Treasury, notified in writing, the respondent, William Penn Laundry, Inc., that an additional inspection of its books and records was necessary. Exhibit "A-2" which is attached hereto and incorporated herein is a copy of said notification the original of which was previously delivered to Max Powell, President of the said respondent by Ernest J. Tiberino, Jr., on March 4, 1963, as appears more fully in the affidavit of the said Ernest J. Tiberino, Jr., which is attached hereto as Exhibit "A-1".

VII.

On March 12, 1963, a summons was issued by Ernest J. Tiberino, Jr., Special Agent, Internal Revenue Service, directing the respondent, Max Powell, as President of William Penn Laundry, Inc., to appear before the said Ernest J. Tiberino, Jr., on March 25, 1963, at 10:00 A. M., and to produce for examination certain books, records and papers of William Penn Laundry, Inc. A copy of said summons was personally served upon Max Powell by the said Ernest J. Tiberino, Jr., on March 13, 1963, and is attached hereto as Exhibit "B".

VIII.

The respondent; Max Powell, appeared in response to the summons described in paragraph VII above, but refused to produce the books, records, and papers demanded, and such refusal continues to the date of this petition as is all more fully set out in the transcript of testimony attached herefo as Exhibit "C".

WHEREFORE, the petitioners respectfully pray:

1. That the Court enter an order directing the respondents, William Penn Laundry, Inc., and Max Powell, as President of the respondent corporation, to show cause, if any they have, why they should not comply with and obey the aforementioned summons in each and every requirement thereof.

2. That the Court enter an order directing the respondent, Max Powell, to obey the aforementioned summons in each and every requirement thereof, and to order the attendance and production of books and records as required and called for by the terms of such summons before Special Agent Ernest J. Tiberino, Jr. or any other proper officer of the Internal Revenue Service, at such time and place as may be hereafter fixed by said Ernest J. Tiberino, Jr., or any other proper officer of the Internal Revenue Service.

3. That the Court grant such other and further relief as to the Court may seem just and proper.

/s/ DREW J. T. O'KEEFE,
Drew J. T. O'Keefe,
United States Attorney.

/s/ SIDNEY SALKIN,
Sidney Salkin,
Asst. United States Attorney,

Petition to Enforce Summons

UNITED STATES OF AMERICA
EASTERN DISTRICT OF PENNSYLVANIA } ss:7

I, Ernest J. Tiberino, Jr., Special Agent, Internal Revenue Service, do hereby make a solemn oath that the statements contained in the foregoing petition are true to the best of my knowledge, information and belief.

/s/ ERNEST J. TIBERINO, JR.
Ernest J. Tiberino, Jr.

Subscribed and sworn to before me this 20th day of May, 1963.

/s/ RICHARD DiCERBO,
Dep. Clerk, U. S. D. C., E. D. Pa.

EXHIBIT "A-1".

AFFIDAVIT.

UNITED STATES OF AMERICA
EASTERN JUDICIAL DISTRICT OF PENNSYLVANIA } ss.:

Ernest J. Tiberino, Jr., being duly sworn, according to law, deposes and says:

(1) That he is a Special Agent, Intelligence Division, Office of the District Director of Internal Revenue, Philadelphia, Pennsylvania.

(2) That since February 1963, in his capacity as a Special Agent, he has been investigating the correctness of the corporation income tax returns of William Penn Laundry, Inc., for the fiscal years ending July 31, 1958, and July 31, 1959.

(3) That based upon the above investigation, the Regional Commissioner, Internal Revenue Service, determined that an additional examination pursuant to Section 7605(b) of the books and records of the William Penn Laundry, Inc., for the fiscal years ending July 31, 1958, and July 31, 1959, was necessary.

(4) That pursuant to Section 7605(b) on March 4, 1963, he delivered to Max Powell, President, William Penn Laundry, Inc., a letter dated February 26, 1963, from the Regional Commissioner of the Internal Revenue Service which notified the William Penn Laundry, Inc., that an additional inspection of their books and records was necessary. A copy of said letter is attached to this affidavit and marked Exhibit "A-2".

(5) That on the basis of the information obtained in the above investigation, he has reason to suspect that the

William Penn Laundry, Inc., has filed false and fraudulent corporate income tax returns for its fiscal years ending July 31, 1958, and July 31, 1959, with the intent to evade its taxes and has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years.

(6) That it is necessary to inspect the books and records demanded in the summons to ascertain the correctness of said returns and whether said returns were false and fraudulent.

/s/ ERNEST J. TIBERINO, JR.

Subscribed and sworn to before me this 20th day of May, 1963.

/s/ RICHARD DiCERBO,
Dep. Clerk, U. S. D. C., E. D. Pa.

EXHIBIT "A-2".

U. S. TREASURY DEPARTMENT
Internal Revenue Service
Regional Commissioner
Fifth Floor
2 Penn Center Plaza
Philadelphia 2, Pa.

In Reply Refer to
I:R

February 26, 1963

William Penn Laundry, Inc.
4112 Frankford Avenue
Philadelphia, Pennsylvania

Gentlemen:

While it is the practice of the Internal Revenue Service to make as few inspections of books of account and records of taxpayers as possible, it is deemed necessary to make a reinvestigation of the books and records of the William Penn Laundry, Inc. for the fiscal years ending July 31, 1958 and July 31, 1959 in order to properly verify its returns for those years. A re-examination, therefore, will be made.

Your cooperation in permitting our representative access to all of the company's books and records will be appreciated.

This notice is sent in compliance with Section 7605 of the Internal Revenue Code of 1954.

Very truly yours,

(Signed) Dean J. Barron
Dean J. Barron
Regional Commissioner

EXHIBIT "B".**U. S. TREASURY DEPARTMENT
Internal Revenue Service**

Form 2039

SUMMONS

In the matter of the tax liability of

William Penn Laundry, Inc.
4100 Frankford Avenue
Philadelphia 24, Pennsylvania
Internal Revenue District of Philadelphia

Period(s) FYE 7-31-58 and FYE 7-31-59

THE COMMISSIONER OF INTERNAL REVENUE

To: Max Powell, President

At: William Penn Laundry, 4100 Frankford Avenue,
Philadelphia**GREETING:**

You are hereby summoned and required to appear before Ernest J. Tiberino, Jr., an officer of the Internal Revenue Service, to give testimony relating to the tax liability and/or the collection of the tax liability of the above named person for the period(s) designated and to bring with you and produce for examination the following books, records, and papers at the time and place hereinafter set forth:

Minute books

Stock certificate books

General ledgers

General journals

Purchase journals and cash disbursement journals

Sales journal and cash receipts journals

and all subsidiary records kept to substantiate the entries in the above-mentioned records.

Place and time for appearance:

At Office of the Intelligence Division, Internal Revenue Service, Mezzanine Floor, 401 N. Broad St., Phila. on the 25th day of March, 1963, at 10 o'clock A. M.

Failure to comply with this summons will render you liable to proceedings in the district court of the United States or before a United States Commissioner to enforce obedience to the requirements of this summons, and to punish default or disobedience.

Issued under authority of Section 7602, Internal Revenue Code of 1954

this 12th day of March, 1963.

ORIGINAL

Signature: ERNEST J. TIBERINO, JR.
Ernest J. Tiberino, Jr.
Title: Special Agent

CERTIFICATE OF SERVICE OF SUMMONS

(Pursuant to Section 7603, Internal Revenue Code of 1954)

I hereby certify that I served the summons
on the reverse hereof

Date Summons Served (Day, month, year) Time
On March 13, 1963 8:45 AM

How Summons Was Served (Check one)

- ☒ I handed an attested copy thereof to the person to whom it was directed,
- ☐ I left an attested copy thereof with the following person at the last and usual place of abode of the person to whom it is directed,

Signature

ERNEST J. TIBERINO, JR.

Title

Special Agent

Sec. 7603. Service of Summons.—A summons issued under section 7602 shall be served by the Secretary or his delegate, by an attested copy delivered in hand to the person to whom it is directed, or left at his last and usual place of abode; and the certificate of service signed by the person serving the summons shall be evidence of the facts it states on the hearing of an application for the enforcement of the summons. When the summons requires the production of books, papers, records, or other data, it shall be sufficient if such books, papers, records, or other data are described with reasonable certainty.

EXHIBIT "C".

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Testimony of

MAX S. POWELL
6138 Old York Road
Philadelphia, Pennsylvania

In re

William Penn Laundry, Inc.
4100 Frankford Avenue
Philadelphia, Pennsylvania

Testimony of **MAX S. POWELL**, 6138 Old York Road, Philadelphia, Pennsylvania, taken in the office of the Intelligence Division, Internal Revenue Service, 401 North Broad Street, Philadelphia, Pennsylvania, at 9:55 A. M., on Monday, March 25, 1963, in the matter of the income tax liability to the United States of **William Penn Laundry, Inc.**, 4100 Frankford Avenue, Philadelphia, Pennsylvania.

PRESENT

Max S. Powell	Witness
Herbert S. Mednick, Esq. ...	Representing Witness
Packard Building	
Philadelphia 2, Pennsylvania	
Ernest J. Tiberino, Jr.	Special Agent
Coleman Raines	Internal Revenue Agent
Virginia M. Arner	Reporting Stenographer

Questions were asked by Special Agent Tiberino and answers made by Mr. Powell, unless otherwise indicated.

Mr. Tiberino: Mr. Powell, I will be directing my questions to you. You were served with a Treasury Department summons and requested to appear here today to give testimony and furnish records in the matter of the tax liability of William Penn Laundry, Inc., for the fiscal years ending July 31, 1958, and July 31, 1959.

1. Q. Would you please stand and raise your right hand. Do you swear that the answers you are about to give to the questions asked will be the truth, the whole truth, and nothing but the truth, so help you, God?

A. I do.

2. Q. Be seated please. What is your full name?

A. Max, M-A-X, S. Powell, P-O-W-E-L-L.

3. Q. And your home address?

A. 6138 Old York Road, Philadelphia.

(--1--VMA--MSP)

4. Q. And who is with you today, Mr. Powell?

A. Mr. Herbert Mednick, counsel for William Penn Laundry, Incorporated.

Mr. Tiberino: I would like the record to show that Mr. Mednick has produced a U. S. Treasury Department enrollment card showing date March 18, 1963.

Let the record show that there is a power of attorney on file with the District Director of Internal Revenue dated March 21, 1963, whereby Mr. Mednick is shown as the representative of William Penn Laundry, Incorporated.

Mr. Tiberino (resuming):

5. Q. Mr. Powell, what is your position with the William Penn Laundry?

A. My present position is President and Treasurer.

6. Q. And how long have you held these positions with William Penn Laundry?

A. After Mr. Kline's decease. I don't know the months. I don't know the exact date.

Mr. Mednick: Approximately.

(A. No. 6 cont'd.) Approximately—Mr. Kline deceased in October 2, 1961, and sometime after that, when I was elected. Sometime after that; not immediately.

Mr. Tiberino (resuming):

7. Q. Prior to October, 1961, what position did you hold with William Penn Laundry?

A. Vice President and Secretary.

8. Q. Mr. Powell, you were requested to bring with you certain corporate records of William Penn Laundry for the years ending 7/31/58 and 7/31/59, namely, minute books. Do you have them with you today?

A. I do not have them with me today because, on the advice of our counsel, Herbert Mednick, Esq., I did not bring those books.

9. Q. You were also requested to bring stock certificate books of the corporation. Do you have those with you today?

A. On the advice of our counsel I did not bring them. I accepted the advice of our counsel.

(—2—VMA—MSP)

10. Q. You were also requested to bring general ledgers of the corporation for those years. Do you have those with you today?

A. On the advice of our counsel, I did not bring them.

11. Q. You were also requested to bring general journals.

A. I did not.

12. Q. Any reason for not bringing the journals?

A. On the advice of counsel.

13. Q. Also requested were purchase journals and cash disbursements journals. Do you have those with you?

A. I do not. On the advice of counsel I did not bring them.

14. Q. Also requested were sales journals and cash receipts journals. Do you have those with you today?

A. I did not bring them, on advice of counsel.

15. Q. You were also requested to bring subsidiary records to substantiate the records I just mentioned. Do you have any records at all with you today?

A. I do not have any records with me today on the advice of counsel.

Mr. Tiberino: And I presume, Mr. Mednick, that at this point you would like to give your position?

Mr. Mednick: That is correct. I would like to make a statement, if I might.

Mr. Tiberino: Go right ahead.

Mr. Mednick: Mr. Powell is here today in his capacity of President of the William Penn Laundry, Inc. to honor the summons which was served upon him. It is his desire, and the company's desire, to cooperate in every way that is proper and legal. However, in view of the fact that the Statute of Limitations has expired for the two years for which time you have requested records, plus the fact that these years were previously examined and the principal officer at the time is no longer living, I have advised Mr. Powell to decline to produce these records and to waive any legal rights which the corporation may have or which he may have.

It is our position that this is an unreasonable examination, and in view of the expiration of the Statute of Limitations, such examination would be illegal. To Mr. Powell's knowledge, the returns of

(—3—VMA—MSP)

the corporation for the years in question are correct and he has no reason to know of any discrepancies which could be the basis for an allegation of fraud. Under the circumstances, unless the taxpayer was given some indication or showing of fraud, the law does not permit an examination of the records for these two barred years.

This position is taken on the basis of substantial legal authority, the most recent of which is the case of *John A. Howard*, 63-1 USTC, Paragraph 9201, which was decided this year before United States District Court for the Western District of Pennsylvania. I point out that the Judge, in that decision, cited as authority a case decided by the Court of Appeals for this Circuit, the Third Circuit, *Zimmerman v. Wilson*, 105 Fed(2) 583.

If you would be willing to give us some indication of the allegation here or justification for opening such closed years, we would be willing to consider or reconsider our position. Unless that is done, however, we have no alternative but to abide by the Statute of Limitations provision in the Internal Revenue Code.

Mr. Tiberino: O. K. gentlemen, in view of the position taken today, there is no point in carrying this meeting any further at this time.

Mr. Tiberino (resuming):

16. Q. Mr. Powell, is there anything further you wish to say at this time?

A. I accept the advice of my counsel.

Mr. Mednick: Excuse me. [To Mr. Powell] You said "advice of counsel". Would you confirm the fact that the "advice" is related to the Statute of Limitations?

(A. No. 16 cont'd.) Relating to the Statute of Limitations.

Mr. Mednick: Can I ask him a question? [To Mr. Powell] Are you a shareholder of William Penn Laundry?

Mr. Powell: No, I am not.

Mr. Mednick: Have you ever been a shareholder?

Mr. Powell: I have not.

(—4—VMA—MSP)

Mr. Mednick: Who was the principal officer and operator of William Penn Laundry prior to October, 1961?

Mr. Powell: Lawrence C. Kline.

Mr. Mednick: Thank you.

Mr. Tiberino: Is that it, gentlemen?

Mr. Mednick: Yes, sir.

(10:10 A. M.)

[The statement was reopened at 10:11 A. M. in order that the following pertinent statement might be included in the record:]

Mr. Tiberino: Do you have any request to make, Mr. Mednick, for the record?

Mr. Mednick: In view of the fact that Mr. Powell is here pursuant to compulsory process and the Administrative Procedures Act provides for the obtaining of a copy of the transcript where a witness is sum-

moned to appear before a Federal administrative body, I respectfully request that Mr. Powell be given a copy of the record of his testimony within the next week or two, or a reasonable period. He will, of course, be willing to sign such transcript after he has reviewed it for accuracy.

Mr. Tiberino: At this time, Mr. Mednick, I will say that your request will be considered.

(10:12 A. M.)

(—5—VMA—MSP)

UNITED STATES OF AMERICA
EASTERN JUDICIAL DISTRICT OF PENNSYLVANIA } ss.:

I have carefully read the foregoing statement, consisting of 5 pages, which is a transcript of questions which were propounded to me and my answers to such questions on the 25th day of March, 1963, at Philadelphia, Pennsylvania, relative to the income tax liability to the United States of William Penn Laundry, Inc., 4100 Frankford Avenue, Philadelphia, Pennsylvania. I hereby certify that the foregoing answers are true and correct, and that I have made the corrections shown and have placed my initials opposite each correction, and that I have initialed each page of the statement.

MAX S. POWELL.

Subscribed and sworn to before me at 10:30 A. M., this 8th day of April, 1963, Intelligence Division, I. R. S., 401 North Broad St., Phila., Pa.

ERNEST J. TIBERINO, JR.,
Ernest J. Tiberino, Jr.,
Special Agent.

Max S. Powell

I, Virginia M. Arner, Report Stenographer, do hereby certify that I took the foregoing statement of Mr. Max S. Powell in shorthand and personally transcribed it from my shorthand notes, and I have initialed each page.

March 25, 1963

VIRGINIA M. ARNER.

(Date)

I, Ernest J. Tiberino, Jr., Special Agent, do hereby certify that, to the best of my recollection, the above is a true transcript of questions propounded to Mr. Max S. Powell and answers given by him at the above time and place.

3-26-63

ERNEST J. TIBERINO, JR.

(Date)

I, Coleman Raines, Internal Revenue Agent, do hereby certify that, to the best of my recollection, the above is a true transcript of questions propounded to Mr. Max S. Powell and answers given by him at the above time and place.

4/8/63

COLEMAN RAINES.

(Date)

RESPONSE TO ORDER TO SHOW CAUSE.

Comes now Max Powell and William Penn Laundry, Inc., by their attorneys, Fred L. Rosenbloom and Herbert S. Mednick, and show as follows:

I.

William Penn Laundry, Inc. is a Pennsylvania corporation, with its principal place of business in Philadelphia, Pennsylvania. Max Powell, a resident of Philadelphia, Pennsylvania, is presently president of William Penn Laundry, Inc.

II.

In the present proceeding, Ernest J. Tiberino, Jr., a Special Agent of the Internal Revenue Service, seeks judicial enforcement of an Internal Revenue Summons compelling the production by William Penn Laundry, Inc. and Max Powell, of books and documents for the fiscal years ending July 31, 1958 and July 31, 1959.

III.

During the years in question, Lawrence Kline was president of William Penn Laundry, Inc., and owned 100% of its stock. Lawrence Kline died in October, 1961.

IV.

After the death of Lawrence Kline, Max Powell was elected president of the William Penn Laundry, Inc. Max Powell has no stock interest in the corporation.

V.

The tax returns for the years here involved, namely, the fiscal years ending July 31, 1958 and July 31, 1959,

were timely filed, and have heretofore been examined by Agents of the Internal Revenue Service, at which time all of the books and records of William Penn Laundry, Inc. were made available to them. Pursuant to such examination, adjustments were made and deficiency taxes were assessed and, in due course, paid.

VI.

Section 6501 of the Internal Revenue Code provides that except as otherwise provided in the Section the amount of tax imposed shall be assessed within 3 years after the return was filed. More than 3 years have elapsed since the returns for the years in issue were filed.

VII.

The Internal Revenue Summons here involved, served March 13, 1963, without any reference to the above stated facts, demanded that the taxpayer comply with a sweeping order to turn over to Special Agent Ernest J. Tiberino, Jr. all of its books and records for the fiscal years ending July 31, 1958 and July 31, 1959. The Summons had been preceded by a letter to the taxpayer dated February 26, 1963, signed by the Regional Commissioner of the Internal Revenue Service, advising the taxpayer that a re-examination was going to be made of the taxpayer's books for the fiscal years in question.

VIII.

On March 25, 1963, an administrative hearing was held in connection with the Internal Revenue Summons here involved, at which hearing the taxpayer called attention to the statute of limitations bar and, through its counsel, requested Special Agent Tiberino to give some justification for attempting to open the closed years in question, stating that the taxpayer would be willing to reconsider its position

if such justification were offered. Special Agent Tiberino declined to give any justification for the decision to re-examine the fiscal years in question or for the demand by Summons that the taxpayer produce all of its books for the closed years.

IX.

In view of the above described refusal to offer any justification, the taxpayer declined to comply with the Internal Revenue Summons, standing on its legal right to do so.

Thereafter, the instant application was made by Special Agent Tiberino to this honorable Court for enforcement, as though the matter involved an ordinary action for judicial enforcement of an administrative subpoena.

WHEREFORE, Max Powell and William Penn Laundry, Inc. respectfully request that the Order to Show Cause heretofore issued in this matter be dissolved and that the motion for enforcement of Special Agent Ernest J. Tiberino, Jr. be denied.

/s/ FRED L. ROSENBLOOM
Fred L. Rosenbloom

/s/ HERBERT S. MEDNICK
Herbert S. Mednick,
*Attorneys for Max Powell
and William Penn Laundry, Inc.*

SCHNADER, HARRISON, SEGAL
& LEWIS,
1719 Packard Building,
Philadelphia 2, Pennsylvania,
Of Counsel.

June 5, 1963.

**EXCERPT FROM TRANSCRIPT OF HEARING OF
JUNE 5, 1963 RE: ORDER TO SHOW CAUSE.**

(2) *

Mr. Fuerth: Your Honor, Basically we brought this petition in order to enforce compliance with an Internal Revenue summons that was issued by Ernest J. Tiberino, and I think as is set out in our affidavit, the agents of the Internal Revenue Service have been investigating the correctness of the corporate income tax returns for the William Penn Laundry for the fiscal years ending July 31st, 1958 and July 31st, 1959 since approximately either the end of January or the beginning of February.

The Court: Is summons the correct word, or subpoena?

Mr. Fuerth: No, this is captioned a summons.

The Court: That's according to the statute?

Mr. Fuerth: Yes, the summons is issued pursuant to

(3)

Section 7602 of the Internal Revenue Code of 1954 and this proceeding is brought under the provisions of Section 7604 of the Internal Revenue Code of 1954.

Basically what has happened is, after a sort of—the initial investigation—it was determined that a further investigation was warranted, and the Regional Commissioner of the Internal Revenue, Dean J. Barron, after investigation, sent a letter to the William Penn Laundry, the date of which, I believe, is February 26th, 1963, informing them that he wished to have reinvestigation of their books and records for that year, and subsequent to that time and pursuant to this investigation, the special agent issued a summons directing that the William Penn Laundry and Max

* Figures in parentheses refer to page numbers of typewritten transcript.

Powell, President, bring in the matters that were listed in the summons; the minute books, the stock certificate books, the general ledgers, the general journals, purchase journals and cash disbursements journals; sales journal and cash receipts journals, and all subsidiary records kept to substantiate the entries in the above mentioned records.

The summons was issued on March 12th and was served on the President the following day, March 13th, and was returnable on March 25th. That is basically what underlies this proceeding.

Now, what I would like to suggest to your Honor,

(4)

it is only a matter of suggestion, is that basically these problems involve a dispute between the position taken in the First Circuit and the position taken in the Ninth Circuit as to the showings that the Government must make for the enforcement of this summons. This is usually referred to as a showing of probable cause.

Apparently what the defense, or the objection of the respondents in this case have, is that the statute of limitations, three year statute of limitations bars a further assessment of taxes for the two fiscal years being investigated, absent a finding of fraud. If there is fraud, of course, the statute of limitations does not apply, and the First Circuit has taken the position that the Government must make a showing of probable cause if fraud exists.

The Court: Probable cause or good cause?

Mr. Fuerth: No, it has been captioned probable cause.

The Court. In civil rules, you know, the one you use to get documents including books for civil—for discovery in civil cases, and that uses the phrase “good cause”.

Mr. Fuerth: Yes, and in opposition the Second Circuit has taken the position that the Government need not make such a showing.

(5)

The Court: Probable cause of what?

Mr. Fuerth: Probably cause that fraud exists. In other words——

The Court: Is that——

Mr. Fuerth: May I go a little further? The real question is whether or not this examination is reasonable and the position, of course, is that the examination is not reasonable because the statute of limitations bars any further assessment unless there is fraud.

Now, what I would like to suggest to your Honor, since this does not involve a dispute between these—primarily these two Circuits, but other Circuits have ruled on it that——

The Court: Just a minute. How can you determine whether there is fraud or this willfulness which is always—income tax records require—unless you can examine for it?

Mr. Fuerth: That basically is our position. Our position is that we are, in effect, being required to show the very fact that we are attempting to establish, sort of chasing our own tail.

The Court: I think it would probably go maybe more to the mind of the Judge than anything else. He might be pretty liberal in permitting an examination because without the complete examination you can't establish the willfulness.

(6)

You call it fraud, but the statutes all say willfulness. I think

Mr. Fuerth: Yes.

The Court: Go ahead.

Mr. Fuerth: What I was going to suggest before going further, since it does involve the decisions in a number of Circuits, I was going to suggest we set up a briefing schedule, if Your Honor would like, and present briefs before argument. After Your Honor has had the opportunity to look at briefs—

The Court: No, let's go right ahead this morning.

Mr. Fuerth: All right, fine.

The Court: I have tried so many income tax cases and I have had so much experience with these things, I don't see why we should delay it.

Mr. Fuerth: I am perfectly willing to proceed. I was going to suggest that.

Basically, Your Honor, the position is that under the summons as issued under the authority of Section 7602 which allows the Service to issue a summons for the purpose of ascertaining the correctness of any return, making a return when none has been made, determining the liability of any person for any Internal Revenue Tax, or the liability

(7)

of law or in equity—and then they go on to say to summon any person having possession, custody or care of books of accounts containing the entries relating to the business of the person liable for tax, or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear—

The Court: That was a long sentence, so I—you did all right on that one, but hereafter, if you intend to use sections of the statute, I would prefer that you read the statute instead of your summary, what you think they mean.

Mr. Fuerth: I appreciate that.

The Court: In order to state exactly what the statute does mean, but that was pretty clear.

Mr. Fuerth: Well, the summons was issued on the authority of that particular section, and the only limitation that the Code provides on this, or substantive restriction, actually, is provided in Section 7605(b) of the Internal Revenue Code of 1954, which uses the words that, "no taxpayer shall be subjected to unnecessary examination or investigation," and it goes on to say, "only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise," or the Secretary advises him in writing.

The Court: You mean if they go over the books

(8)

and later on they think they forgot something, they'd like to do it again, the taxpayer can say no, you are not going to go over it again?

Mr. Fuerth: Unless the Service makes an investigation and notifies them in writing that they intend to do so.

The Court: But I assume you do that just as a matter of decency in any case.

Mr. Fuerth: This is really what Congress intended. It was intended that the taxpayer not be harassed with repeated and repeated efforts to get his books, but if there is some basis for it, the Code contemplates that an additional investigation be made and this is what was done when the Regional Commissioner, Dean J. Barron, mailed a letter to the William Penn Laundry which is a—a copy of which is attached to the Petition and this is the summons that was issued after the oral request to turn over these records was not complied with.

Now, Your Honor, it is our position, or the Government's position, that the law that we would like this Court to accept was set out in the case of Foster versus United States, 265 Fed. 2d 183. It is a Second Circuit Court case in which they state that the Government should not be re-

quired to prove grounds for belief that the liability was not time barred.

(9)

Basically they say that for a summons to be unreasonable within the meaning of Section 7605 does not require the Government to show that this liability was barred by the statute of limitations.

The Court: Has more than three years expired?

Mr. Fuerth: Yes. The tax years involved are the fiscal years ending July 31st, 1958 and July 31st, 1959.

The three year period limitation for the '58, of course, expired in 1961.

The Court: Therefore the burden is on the Government to show that there was willfulness or fraud, and your proof has to go into that.

Mr. Fuerth: In a tax prosecution or collection case, Your Honor.

The Court: How about the problem here of getting the summons?

Mr. Fuerth: Our position, Your Honor, is that in order to establish this case these are the very books that we need to establish it. We feel that the reason—

The Court: Can you establish it when obviously the statute of limitations has run unless you can show fraud?

Don't you have to start out by showing that there is fraud or willfulness before you can make me move at all, because my first reaction is, well, the statute of

(10)

limitations has run.

Mr. Fuerth: The statute of limitations, Section 6501 of the Code, refers to the assessment and collection of the taxes.

The Court: Not to the issuing of the summons?

Mr. Fuerth: Not to the issuance of the summons.

The Court: Then what could the defense be if you show there is good and probable cause, and I am satisfied there is probable cause of a crime; then it will automatically follow.

Mr. Fuerth: This is our—

The Court: That's simple enough. Let's get to the trial.

Mr. Fuerth: Your Honor, it is our position that we have made this showing in the affidavit. It was the affidavit by the agent submitted hereto. It is our position that—

The Court: If we are having a hearing here I am not trying this case on affidavits, I am trying it on live witnesses.

Go ahead with your live witnesses.

Mr. Fuerth: Your Honor, I have no live witnesses. It is our position that this is a matter that can be tried on affidavits. I don't mean to be disrespectful to the Court.

The Court: What does the statute say about

(11)

a hearing? Why am I here this morning?

Now, you quote the statute as to why I am here this morning. I don't want your summation, what you think it says.

Mr. Fuerth: It is Section 7604 of the Internal Revenue Code which provides enforcement. "When any person summoned under Section 7602"—which is the applicable statute—"neglects or refuses to obey such summons, or to produce books, papers, records or other data, or to give testimony, as required, the Secretary or his delegate, may apply to the Judge of the District Court, or to a United States Commis-

sioner for the District within which the person so summoned resides or is found for an attachment against him, as for a contempt. It shall be the duty of the judge or the commissioner to hear the application and if satisfactory proof is made, to issue an attachment, directed to some proper officer, for the arrest of such person, and upon his being brought before him to proceed to a hearing of the case."

The Court: That means you have to carry a burden of showing that as a proof. Now, those are the words used in the statute. You know we don't try cases on affidavit, we try cases on live witnesses.

Why do you think you can come into a hearing now and say we won't produce any witnesses, we have an affidavit?

(12)

Why is this any different from any other kind of a hearing that we have in court?

Mr. Fuerth: Your Honor, I am not requesting this Court to make an attachment, I am merely asking this Court to make an order which can—

The Court: Well, I haven't read the affidavit but I assume it contains enough to establish the prima facie case.

Mr. Fuerth: Yes, the affidavit, if I may read from it—

The Court: Well, no, you needn't do that. I will hear from the other side.

I will disagree very violently on some of these things, but let's hear from the other side.

Mr. Rosenbloom: May it please the Court, briefly the basic factual situation here set forth is in a response which we have filed and served on counsel for the Special Agent and the petition involves the income tax liability, as my worthy adversary has said, of the William Penn Laundry and Max Powell as President for the fiscal years ending July 31st, 1958 and July 31st, 1959.

Returns for each of those years were timely filed and each of those returns was carefully audited by an agent of the Internal Revenue Service.

(13)

Pursuant to those audits, at which time all the books and records involving the summons presently before the Court were made available to the agents, and to the extent they deemed necessary were carefully examined and carefully reviewed, following which adjustments were made and some deficiency taxes were assessed, and in due course paid.

Now, more than three years after the returns in question were filed—

The Court: Was any suggestion ever made that this man was guilty of what the Government has called fraud or willful failure to pay, or anything like that?

Mr. Rosenbloom: Not to my knowledge, Your Honor. May I read this affidavit which is attached to the pleadings?

The Court: Yes.

Mr. Rosenbloom: As soon as I can find it.

The allegation number 5 in the affidavit, which is a conclusory document, by the way, it doesn't state facts, goes on to say:

"That on the basis of the information obtained in the above investigation, he has reason to suspect that the William Penn Laundry, Inc. has filed false and fraudulent corporate income tax returns for its fiscal years ending

(14)

July 31st, 1958 and July 31st, 1959, with the intent to evade its taxes and has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made, which in turn were used as expenses—" and so on and so on.

Now, he has done this. I have no facts nor has the Court any facts on which to support his conclusion that fraud exists. Now, I would like to develop this, Your Honor, in my argument.

By the way, Mr. Fuerth neglected to state that while it is true we have no authority from the Court of Appeals in this Circuit, we have two recent cases decided by District Courts in this Circuit, one by the Western District in Pittsburgh, one by the District in Delaware, directly on point, and in neither case was the Government's request supported.

In both cases—in one case it was a motion by the taxpayer to quash a subpoena and that was granted, and the other case was a matter by—a motion by the Government in a situation such as this, and it was denied, so we do have authority.

We are not in the Second Circuit, we are in the Third Circuit, and we have two cases right on point, one of them decided only two weeks ago.

Meanwhile I would like to hand those up to

(15)

Your Honor.

The Court: In Delaware?

Mr. Rosenbloom: Yes, Judge Wright.

The Court: Who was the Judge in the Western District?

Mr. Rosenbloom: Judge Dunbould.

May I call Your Honor's attention to Judge Wright's opinion in the Carey case, and I am going to quote from— if Your Honor will permit me to point this language out to you on page 88359. This is directly on point.

May I read it, sir, for the record?

The Court: I am reading it from this.
Go ahead.

Mr. Rosenbloom: I would like now to develop my thought. Now, more than three years after the returns in question were filed and without any attempt to justify or explain the action, a demand was made on the taxpayer by a Regional Commissioner's letter of February 26th, 1963, that the taxpayer permit another examination of all the books and records for those two years.

The Court: How long did they have them the first time?

Mr. Rosenbloom: I don't know, Your Honor. All I know is that from my own experience as a Revenue Agent, you

(16)

come out and ask for the books and records. They are presented to you as they were here. You make an examination on the taxpayer's premises and you keep them as long as you, the examining officer, feel it is necessary.

Now, a full examination was made. I assume the Revenue Agent did his duty. He made an examination. He made some changes which resulted in deficiency taxes. He discussed those with the taxpayer or the taxpayer's representatives. They were agreed upon, the amounts were assessed and the assessments were ultimately paid.

Now, more than three years later without any notice, along comes this Commissioner's letter in which he states it is deemed necessary—deemed by whom? and on what basis? It is deemed necessary to make this reexamination.

The Court: What actually happened? Was a new man put on the job, do you know?

Mr. Rosenbloom: Yes, a Special Agent, a Special Intelligence Agent this time. We don't know why, we don't know the basis for it; all we know is he comes in and asks for a reexamination. If I may go on I will develop this.

Mr. Max Powell, who is now the President of this corporation—a man who was President of the corporation at

the time involved in these two years, in these two returns, died in October, 1961—the President, Mr. Max Powell,

(17)

accompanied by Mr. Mednick, one of my partners, appeared at a hearing before Special Agent Tiberino in answer to the first summons in March, 1963, to explore the situation.

At that time, Mr. Mednick made the following statement which I quote from the transcript of the hearing which was attached to the petition. I am now quoting. Mr. Mednick said to Mr. Tiberino:

“If you would be willing to give us some indication of the allegation here, or justification for opening such closed years, we would be willing to consider or reconsider our position. Unless that is done, however, we have no alternative but to abide by the statute of limitations provision in the Internal Revenue Code.”

The Special Agent's response to this statement was the remark that there was— “. . . no point in carrying this meeting any further at this time.”

In other words, and this has since been made clear in subsequent conversations with the Special Agent, the Service flatly refused to furnish any justification for its demand that the closed years be reopened.

In view of the situation which developed at this hearing, the taxpayer had no alternative——

The Court: Mr. Rosenbloom, is Mr. Tiberino here today?

(18)

Mr. Rosenbloom: No, I don't see him.

The Court: He is the Special Agent. I don't see why he isn't here to testify and give me some explanation aside from this affidavit so he can be cross-examined.

Mr. Rosenbloom: Well, I am not responsible for Mr. Tiberino, but I can say this to Your Honor. I know this

is the attitude of the Internal Revenue Service. They want it. That is sufficient.

The Court: They are going to run right over all the taxpayers to get it.

Mr. Rosenbloom: Not all of them.

The Court: —whenever they want something, and that isn't the attitude Congress wants, or the Courts want. He won't even bother to come in here to testify to say why he wants it.

Mr. Rosenbloom: This is not the reason why Congress put a statute of limitations in the law. They didn't put it in for makeweight.

The Court: I wonder if it is necessary to take any time with this.

Mr. Fuerth—is that your name?

Mr. Fuerth: Yes, sir.

The Court: Suppose I give you folks an hour to go over these books. Would that be enough?

(19)

Mr. Faerth: Your Honor—

The Court: Why spend any more time on this. I don't think any more of Mr. Powell's time should be taken on this examination than is absolutely necessary.

Mr. Rosenbloom: Mr. Powell is here, by the way.

The Court: I suspected that was Mr. Powell.

Mr. Fuerth: Your Honor, I am informed by the—someone from the Internal Revenue Service here, that an hour would be sufficient.

The Court: Well now, why fight over a problem that would only take an hour? I am inclined to go along with

Mr. Rosenbloom's argument from reading this, but as a practical matter, an hour examination of these books in a courteous way, understand—I don't know how the Special Agent acts, but if he will do this in a courteous way and a kindly way, without assuming these people are guilty of anything, I am inclined to let them have an hour to do this.

When would be the most satisfactory to you, Mr. Powell?

Mr. Rosenbloom: Mr. Powell is sitting back here. This is my partner, Mr. Mednick. Mr. Powell is in the courtroom.

The Court: Mr. Powell, will you come up for a minute? Mr. Tiberino not having bothered to come here.

(20)

he will have to take the time I fix for him.

Mr. Fuerth: Your Honor, I can assure you Mr. Tiberino will comply with any order the Court makes, and that he will behave himself in a courteous and gentlemanly manner, there is no question about that.

The Court: They don't always.

Mr. Fuerth: Your Honor, you have my personal assurances that I will instruct him so.

The Court: When would be a convenient time for you, Mr. Powell. When would be a convenient time for you to let Mr. Tiberino have a look at them, not more than an hour, at your books?

Mr. Rosenbloom: Well, may I address myself to this, Your Honor? I am not at all certain that Mr. Tiberino or anybody else is entitled to this.

The Court: But they did it before.

Mr. Rosenbloom: But the statute has run, Your Honor.

The Court: He might have photographed the whole thing.

Mr. Rosenbloom: But the statute has run. This limitation was put in there by Congress for a purpose.

The Court: Yes, we can have a hearing here and we can have an argument in argument court, and you can present

(21)

findings of fact and conclusions of law, and I can present an opinion like the other Judges did.

For what? For an hour's time that Mr. Powell might give to Mr. Tiberino. He might think well, the principle is——

Mr. Rosenbloom: It is a very important principle, Your Honor.

The Court: Somebody apparently didn't do the examination thoroughly the first time and to me, compared with some of the other principles, it doesn't seem so important. I think the best way to handle this is to ask Mr. Powell when would be a convenient time for him and tell Mr. Fuerth that if Mr. Tiberino wants to see those books I will give him no more than an hour at that time to look at them and that, I think—it will be all over with. I don't mean the result of the investigation, the investigation will not be over, but as far as this particular aspect of it is concerned it will be over.

What would be a convenient time for you, Mr. Powell?

Mr. Powell: I would have to find out just exactly what time would be mutually convenient for Mr. Tiberino and myself.

The Court: No, you won't. You tell me what is

(22)

convenient and I will tell Mr. Fuerth that that's when Mr.

Tiberino will have to be there if he wants to see them. If he isn't there at that time he won't see the books.

He didn't come here to testify this morning to subject himself to cross-examination, so I am not too much concerned about his convenience.

Mr. Rosenbloom: But Your Honor, this is the real meat of this problem, whether he is entitled to see these books again.

The Court: I am not too much concerned about that.

Mr. Rosenbloom: If Your Honor is going to rule that he has the right to see them, that's one thing, but I don't think he should get another crack at these books just because he wants to see them. That's the crux of this case.

The Court: I know, but you aren't very practical in this, Mr. Rosenbloom.

Mr. Rosenbloom: Well, I have always considered myself quite practical.

The Court: No, I don't think in this—looking at it that way, you are making a big thing out of something that really isn't big. I don't think it is in the interest of your client or anybody else to be—make too big a thing out of this.

(23)

Mr. Rosenbloom: I think if Mr. Tiberino would tell us what he has in mind—

The Court: He does in this affidavit. He thinks the expenses, I think it is, were overstated.

Mr. Rosenbloom: He says he thinks that purchases were overstated.

The Court: How can they find out whether they were or weren't if they can't look at the books?

Mr. Rosenbloom: We will show them the purchases book.

The Court: Sure, that's—

Mr. Rosenbloom: I don't think Your Honor should ask us to open all of our books to him. If he wants to see the purchases book we will show the purchases book.

The Court: “. . . and has attempted to evade and defeat the taxes due for those years by overstating the amount of purchases made, which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years.”

To a certain extent he can't substantiate it unless he looks.

Mr. Rosenbloom: I will show him the purchases book any time he wants to see it, but I don't think—

The Court: You are not going to limit him to

(24)

any particular book. I am going to let him have an hour to look at Mr. Powell's books, or less, if he can do it in less time, but no more.

Let's fix a time. How about next Monday?

Mr. Powell: I would—

Mr. Rosenbloom: Would next Monday be convenient?

The Court: I am not attempting to go over your head as a lawyer.

Mr. Rosenbloom: I understand, Your Honor.

The Court: This is a problem of convenience.

Mr. Fuerth: Your Honor, I would like to make a request. There are two gentlemen who have been working on this. Are you limiting it just to Mr. Tiberino's presence?

I would like the other gentleman who is working on the case with Mr. Tiberino to be present.

The Court: That will be all right, but I want the most considered courtesy, no browbeating or anything like that.

Mr. Fuerth: I assure you that I will instruct these gentlemen, and I will give the Court my personal assurance of that.

Mr. Rosenbloom: Will next Monday be satisfactory to you?

Mr. Powell: I believe it will, as far as I

(25)

myself am concerned. I would have to get all the books together.

Mr. Rosenbloom: Ten o'clock next Monday morning and——

The Court: Ten o'clock next Monday morning?

Mr. Rosenbloom: That is the purchase books? All the books and the time spent, as I understand Your Honor, is not to exceed beyond one hour from the time they start.

The Court: From ten to eleven in the morning. If they are not there by ten o'clock they will be cut off at eleven. You don't have to sit around all day waiting for them. Do you hear that, Mr. Fuerth?

Mr. Fuerth: Yes, sir.

The Court: Two men, but no more than two men.

Mr. Fuerth: That's right.

The Court: They will come there and they will treat you with the utmost courtesy.

Mr. Fuerth: I assure you.

The Court: I have very grave doubts. I think the practical way to handle this is to let them have that time in a courteous way to look at the books.

Now, do you want an order?

(26)

Mr. Rosenbloom: Yes, I would like an order.

The Court: The reason I ask that, Mr. Rosenbloom, is that there aren't any cases as far as I know in this District, and if I sign an order somebody will cite that, the fact that this point has been decided in the Eastern District, in the Western District and in Delaware.

If we try first of all to see if this won't work out without an order, then the motion can be withdrawn and nobody can say that this has been decided in the Eastern District, but if you want an order it's all right.

Mr. Rosenbloom: May I have just a minute, please?

The Court: Yes.

Mr. Rosenbloom: Will it be an order without an opinion, Your Honor?

The Court: Yes.

Mr. Rosenbloom: Yes, I'd prefer an order.

The Court: I think then, Mr. Salkin, and you, Mr. Fuerth, go upstairs and get an order to me, say, no later than three o'clock this afternoon. Read it to Mr. Rosenbloom before you submit it to me.

I think that you understand clearly now, that two people may see these books between ten and eleven o'clock next Monday morning, one of whom will be Mr. Tiberino.

(27)

Mr. Fuerth: Yes, sir.

The Court: And the other of whom will be—

Mr. Fuerth: Mr. Coleman Raines.

The Court: You can give that to me three o'clock this afternoon. I don't know how many books this corporation has. I am not limiting it to purchases books.

They may look over the books between ten and eleven next Monday morning.

Mr. Salkin: That will be June 10th?

Mr. Rosenbloom: Yes.

The Court: Yes, that will be June 10th.

Mr. Fuerth: That will be at 4100 Frankford Avenue?

Mr. Rosenbloom: Yes.

Thank you, Your Honor.

Mr. Fuerth: Thank you, Your Honor.

(Hearing Adjourned.)

ORDER.

This case having come on for hearing this date, the Pleadings and Attachments thereto having been considered and argument by the respective counsel having been heard, it is hereby

ORDERED

that Max Powell, President of William Penn Laundry, Inc., produce for examination by Special Agent Ernest J. Tiberino, Jr., and Revenue Agent Coleman Raines, at 4100 Frankford Ave., Philadelphia, Pennsylvania, on June 10, 1963, from 10:00 o'clock, A. M., to 11:00 o'clock, A. M., the following books, records and papers, of William Penn Laundry, Inc., for its fiscal years ending July 31, 1958 and July 31, 1959:

Minute books

Stock certificate books

General ledgers

General journals

Purchase journals and cash disbursement journals

Sales journal and cash receipts journals

and all subsidiary records kept to substantiate the entries in the above-mentioned records.

/s/ ALLAN K. GRIM,

J.

*United States District Court for the
Eastern District of Pennsylvania*

Dated: June 5, 1963.

NOTICE OF APPEAL.

Please take notice that William Penn Laundry, Inc. and Max Powell, respondents above named, hereby appeal to the Court of Appeals for the Third Circuit from the order of June 5, 1963, in the above captioned proceeding.

FRED L. ROSENBLOOM,
Fred L. Rosenbloom,
1719 Packard Building,
Philadelphia 2, Pennsylvania,
*Attorney for Appellants Max Powell
and William Penn Laundry, Inc.*

June 7, 1963

ORDER.

Upon consideration of the stipulation of the parties filed of record this date, it is hereby

ORDERED

that compliance with the Order of this Court entered June 5, 1963, is postponed pending the appeal in this action pursuant to the terms of said stipulation.

VAN DUSEN, J.

Dated: June 8, 1963.

*for Allan K. Grim, Jr.
approved by Judge Grim in a phone
conversation at 10:20 AM on this
date.*

STIPULATION.

IT IS HEREBY AGREED by the parties to consent to a stay of the order dated June 5, 1963, pending an appeal of the above captioned action on the condition that in the event the Government prevails in the appeal then the Respondents agree to produce for examination within ten (10) days after the receipt in the District Court of the mandate finally disposing of the appeal in this action, those books and records called for in the Internal Revenue Summons of March 13, 1963, which is the subject of this action, for as long a period of time as is reasonably necessary for the conduct of a proper examination.

IT IS FURTHER AGREED that in the event the appeal is dismissed the scope of the present order shall be expanded so as not to be limited to examination of one hour's duration but rather for as long a period of time as is reasonably necessary for the conduct of a proper examination of said books and records. Respondents reserve the right to resist the order as broadened if necessary to perfect their appeal.

/s/ DREW J. T. O'KEEFE,
Drew J. T. O'Keefe,
United States Attorney,

/s/ SIDNEY SALKIN,
Sidney Salkin,
Assistant United States Attorney,
Attorneys for Petitioners.

/s/ FRED L. ROSENBLOOM,
Fred L. Rosenblom, Esq.,
Attorney for Respondents.

48 In the United States Court of Appeals for the
Third Circuit

No. 14516

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR.,
SPECIAL AGENT, INTERNAL REVENUE SERVICE

v.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC., APPELLANTS

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF PENNSYLVANIA

Argued October 17, 1963

Before: McLAUGHLIN, HASTIE and FORMAN, *Circuit Judges.*

Opinion of the Court—Filed December 23, 1963

By HASTIE, *Circuit Judge:*

The United States and a special agent of the Internal Revenue Service brought this action in the district court, as authorized by section 7604(b) of the 1954 Internal Revenue Code, to compel a corporate taxpayer, William Penn Laundry, Inc., and its president, Max Powell, to obey an administrative summons, issued in March 1963 by special agent Ernest

Tiberino, one of the plaintiffs, directing them to appear
49 before him and to produce for reexamination certain records of the corporation for the years 1958 and 1959.

In response to the summons, Powell appeared before Tiberino at a formal hearing and pointed out that the taxpayer's records for 1958 and 1959 had already been examined, that the normal three-year statute of limitations had run against 1958 and 1959 deficiency assessments, that only to redress fraud could those closed years be reopened and that he knew of no basis upon which fraud could be

attributed to the taxpayer. He then asked agent Tiberino to indicate some justification for reexamining the records in question and refused to produce them otherwise. Tiberino declined to justify his demand and summarily terminated the hearing. He then instituted this enforcement proceeding.

With this petition Tiberino filed in the district court his affidavit asserting that "on the basis of information obtained" in a current investigation of taxpayer's 1958 and 1959 income tax returns, "he has reason to suspect that the William Penn Laundry, Inc., has filed false and fraudulent corporate income tax returns for its fiscal years ending July 31, 1958 and July 31, 1959, with the intent to evade its taxes and has attempted to evade and defeat the taxes due for these years by overstating the amount of purchases made which in turn were used as expenses so as to fraudulently understate the amount of taxable income for the above fiscal years". Answering the petition, the defendants stated what had occurred at the hearing before agent Tiberino and again refused to produce the 1958 and 1959 records unless justification for their reexamination should be shown. When the matter came on for hearing, the plaintiffs elected to make no factual showing beyond Tiberino's affidavit. Indeed, Tiberino was not present, appearing only by counsel. After hearing arguments, the court ordered the defendants to honor the summons and produce their records for Tiberino's examination. The defendants have appealed from that order.

50 We first summarize the relevant provisions of the 1954 Internal Revenue Code. Section 7602 confers upon the Secretary of the Treasury or his delegate very broad power to summon witnesses and to require the production of records "as may be relevant or material" to inquiry into tax liability. Section 7605(b) prohibits subjecting a taxpayer "to unnecessary examination or investigations". Section 7604(b) provides that the judge who is asked to enforce an administrative summons shall hear the application and, "if satisfactory proof is made", take coercive action against the person summoned.

On this appeal we must determine in the light of the above cited provisions of the statute what a court's responsibility is when it is asked to enforce an administrative demand to re-examine a taxpayer's records after a return has been filed for the year in question, the taxpayer's supporting records have

been examined, the tax has been paid in accordance with the indicated liability, and the normal three-year statute of limitations¹ has run against any further deficiency assessment. In such circumstances, the imposition of any additional liability upon the taxpayer must be predicated upon fraud. 26 U.S.C. § 6501(c) (1). Logically, therefore, a reexamination of his records must be "unnecessary" within the meaning of section 7605(b) unless something has been discovered by the Secretary's delegate which might cause a reasonable man to suspect that there has been fraud in the return for the otherwise closed year. Cf. *Farmers' & Mechanics' Nat. Bk. v. United States*, 3d Cir. 1926, 11 F. 2d 348; *In re Andrews' Tax Liability*, D.Md. 1937, 18 F. Supp. 804. Nevertheless, the government insists that the basis of the Treasury agent's suspicion is not a matter of judicial cognizance. Rather, it is argued, the agent is entitled to judicial enforcement of his demand for the taxpayer's records if he merely submits to the court his affidavit asserting in generality that "he has reason to suspect" that there has been fraud in the taxpayer's computation of his tax for the year in question. In the government's view the agent need not even set out in his affidavit the facts which gave him "reason to suspect" fraud, much less establish by testimony in court that his suspicion is reasonably grounded. This also seems to be the view of the Court of Appeals for the Second Circuit. *Foster v. United States*, 2d Cir. 1959, 265 F. 2d 183, cert. denied, 360 U.S. 912.

Rejecting this view, we consider it significant that section 7604(b) requires a "hearing" on the application to enforce the administrative summons at which "satisfactory proof" shall be made. We think this provision means that the court shall decide on the basis of the showing made in the normal course of an adversary proceeding whether the agent's suspicion of fraud is reasonable. *O'Connor v. O'Connell*, 1st Cir. 1958, 253 F. 2d 365, followed in *Lash v. Nighosian*, 1st Cir. 1959, 273 F. 2d 185, cert. denied, 1960, 362 U.S. 904; *United States v. Carey*, D.Del. 1963, 218 F. Supp. 298. This the court cannot do unless the agent discloses whatever may have created

¹ There is no suggestion here that the six-year statute of limitations applicable to gross understatement of income may be applicable, 26 U.S.C. § 6501(c)(1).

² If facts are alleged in the petition or in a supporting affidavit as the basis of the agent's suspicion and are not denied in a responsive pleading there may be no need to take testimony. Otherwise, the agent must present evidence showing some rational basis for his suspicion.

his suspicion. Since the agent in this case failed to make such disclosure, despite the taxpayer's formal request for it, his application for judicial assistance should have been denied.

Our conclusion is in accord with the ruling of the Court of Appeals for the First Circuit in *O'Connor v. O'Connell*, *supra*, and contrary to the language of the Court of Appeals for the Second circuit in *Foster v. United States*, *supra*. The government also contends that very recent decisions in the Sixth and Ninth Circuits grant the government relief in cases like this one. We do not read those decisions that way.

52 *United States v. Ryan*, 6th Cir. 1963. 320 F. 2d 500.

does contain language suggesting that a court, asked to enforce an internal revenue summons, need not inquire into the reasonableness of administrative suspicion of fraud. However, the opinion shows that the petitioning revenue agent testified in the enforcement proceeding and explained the basis of his apprehension concerning fraud. Moreover, the decisive conclusion of the court of appeals was that "the district court was justified in concluding from the testimony of the Internal Revenue Agent that he ought not to disturb the determination made by the Secretary that the investigation was necessary".

The Court of Appeals for the Ninth Circuit dealt with this problem in *De Masters v. Arend*, 1963. 313 F. 2d 79. There again the petitioning agent testified as to the basis of his suspicion. He had found that deposits in the bank account maintained for the taxpayer's store were substantially greater than the total gross receipts of the business as reported in the taxpayer's income tax return. Moreover, a preliminary computation had indicated an increase in the taxpayer's net worth which far exceeded his reported income. With this testimony before it, the court said that "if it appeared that the decision to investigate * * * [possible fraud] was in fact reached as a matter of rational judgment based on the circumstances of the particular case, then the investigation could not be an 'unnecessary' one prohibited by Section 7605(b), just as the act of issuing an administrative subpoena in such circumstances would not be 'arbitrary' and the subpoena unenforceable." 313 F. 2d at 90. The court concluded that the "showing by the taxpayers in the present case that further assessment was time-barred in the absence of fraud may have been sufficient to require the appellants to go forward with a justification of

their inquiry. But this they did, and the showing which they made was sufficient to establish (1) that further investigation was undertaken pursuant to the Commissioner's authority, and (2) that the decision to proceed was not arbitrary." 313 F. 2d at 91. This is essentially the position that we take in this case.³

The judgment will be reversed.

54 In the United States Court of Appeals for the
Third Circuit

No. 14516

UNITED STATES OF AMERICA AND ERNEST J. TIBERINO, JR.,
SPECIAL AGENT, INTERNAL REVENUE SERVICE

VS.

MAX POWELL AND WILLIAM PENN LAUNDRY, INC., APPELLANTS

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF PENNSYLVANIA

Present: McLAUGHLIN, HASTIE and FORMAN, *Circuit Judges.*

Judgment—December 23, 1963

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court filed June 5, 1963 be, and the same is hereby reversed.

[File Endorsement Omitted]

DECEMBER 23, 1963.

³ Probably the Sixth and Ninth Circuits would sustain administrative judgment as to the need for reexamination of records of closed years upon a less impressive showing of suspicious circumstances than the First Circuit would require. However, this is a matter of quantum of proof which does not concern us here because in showing whatever has been made as to the basis of the special agent's suspicion.

55 In the United States Court of Appeals for the
Third Circuit

No. 14516

[Title Omitted]

Order Staying Issuance of Mandate—February 5, 1964

Pursuant to Rule 36 (2) of this Court, it is ORDERED that issuance of the mandate in the above cause be, and it is hereby stayed until March 2, 1964.

WILLIAM H. HASTIE
Circuit Judge.

FEBRUARY 5, 1964.

[File Endorsement Omitted]

56 [Clerk's Certificate to foregoing transcript omitted in
printing.]

57 Supreme Court of the United States

OCTOBER TERM, 1963

No. 944

UNITED STATES, ET AL., PETITIONER

VS.

MAX POWELL, ET AL.

Order Allowing Certiorari. May 18, 1964

The petition herein for a writ of certiorari to the United States Court of Appeals for the Third Circuit is granted. The case is placed on the summary calendar and set for oral argument immediately following No. 590.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.